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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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April 28, 1993

Ms. Donna Searcy
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

Re: *General Docket No. 90-314, ET Docket No. 92-100*
Notice of Ex Parte Presentation

Dear Ms. Searcy:

Today, Pendleton C. Waugh of Express Communications, Inc. ("Express"), Dawn G. Alexander and the undersigned met with Randall Coleman, Legal Advisor to Commissioner Ervin S. Duggan to discuss Express' proposal for the licensing of Personal Communications Service system operators. The substance of that proposal is contained in the attached memorandum, a copy of which was provided to Mr. Coleman. In addition, we provided Mr. Coleman with a copy of the accompanying consumer advisory distributed by the North American Securities Administrators Association, which warns that the use of auctions "could serve as the biggest bonanza to date for con artists and other sharp operators."

Respectfully submitted,



Paul J. Sinderbrand

PJS/cjl
Enclosures

cc: Randall Coleman
Hon. Ervin S. Duggan

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THE LOTTERY VS. AUCTION CONUNDRUM: A SIMPLE ANSWER FOR PCS LICENSING
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

As the Federal Communications Commission moves closer to the adoption of rules to govern Personal Communications Services ("PCS") licensing, the debate over the use of spectrum auctions has intensified. As Chairman Edward J. Markey made clear in his opening statement at the April 22, 1993 hearing of the House of Representatives Subcommittee on Telecommunications and Finance, the goals in structuring a licensing system must be to provide the Administration with much-needed revenue and to end the abuses that have tarnished the current lottery system, while still preserving an opportunity for innovative entrepreneurs to participate in the wireless communications industry. Express Communications, Inc. ("Express") has a suggestion as to how those oft-conflicting goals can be achieved.

A political consensus is developing that any auction system will have to be crafted to permit payments out of revenues so as not to foreclose small entrepreneurs from participation in the PCS industry. However, permitting entities to bid at auction with future revenues raises two fundamental problems.

First, how will the government determine which bidders are financially qualified to construct and operate PCS systems? In a traditional auction, financial qualification is deemed unnecessary because of the need to make a substantial immediate payment. When the bid amount can be paid out of future revenues, however, something more is needed to assure that the winning bidder can develop its proposed system and is not engaged in speculation.

Second, what will the government do if the winning bidder promises to pay more than system revenues ultimately can support? The risk of overbidding is particularly great with respect to a revolutionary new service like PCS. In all likelihood, at the time of initial auctions no one will have a firm idea of what PCS will be, much less what a PCS system will cost to develop and what revenues it can anticipate. Even those acting in good faith will presumably have differing views of the value of a PCS license. As the Congressional Budget Office has recognized, "[i]n the presence of uncertainty, theory indicates that, on average, the winning bid will also be *too high*." ¹ What will the government do when a winning bidder ultimately finds itself unable to pay the promised share of revenues because its projections were overly

construction,^{2/} (2) ban system sales until construction is well under way,^{3/} and most importantly (3) require applicants to post a performance bond. To raise revenues, require PCS licensees to pay a fixed percentage of gross revenues as a spectrum user fee, with the precise percentage to be determined by the FCC.

The primary benefits of Express' proposal are three.

1. The requirement of rapid system construction and a ban on sales until construction is substantially complete deters speculation, assures prompt service to the public, and guarantees that the government earns user fees quickly.

2. While the lottery system will be open to all, the requirement of a performance bond forces every applicant to demonstrate its *bona fides*. Express and others have previously proposed a variety of mechanisms for reforming the lottery system to deter speculation. The flaw in those proposals, however, is that they have required the FCC to make subjective judgements regarding the qualifications of each applicant. For example, many have proposed that applicants submit a business plan. Yet, anyone can prepare a business plan; what counts is whether the plan is realistic and can be implemented. Those will be difficult judgements for the FCC to make. The performance bond requirement effectively shifts that task to sureties, who will have a tremendous financial incentive to make certain that applicants are qualified and can develop the PCS systems they apply for. Sureties will either scrutinize the business and technical qualifications of their applicants, or will pay a heavy price. Speculators will be unable to meet the performance bond requirement, and will fall by the wayside. While the use of performance bonds may seem complex, there are extensive regulations in Part 28 of the Federal Acquisition Regulations System, 48 C.F.R. §28.000 *et seq.* that address virtually every issue that can arise regarding the use of performance bonds. A copy of the relevant portions of Part 28 is attached for convenience.

3. The government will realize substantial revenue from the user fee. Yet, if it ever turns out that the success of PCS in the marketplace is jeopardized because the FCC initially set the user fee too high, the fee can be adjusted in an equitable manner. While Express does not suggest that fees should be adjusted to accommodate the poor performance of any one company, an adjustment applicable to all similarly situated licensees would be appropriate if the FCC misjudged either the cost of providing PCS or marketplace demand in establishing its initial fees. Since the fees will be set by the FCC in the first instance, and not as a result of bidding, losing applicants would have no grounds for objection should the fee structure later be adjusted.

^{2/} Specifically, Express suggests that a PCS licensee be required to serve 20% of the area or population of its service area after one year, 50% after two years and 90% after three years.

^{3/} No system sale should be permitted until 90% of the area or population of the service area is served.

Subpart 27.5—[Reserved]**Subpart 27.6—Foreign License and Technical Assistance Agreements****27.601 General.**

Agencies shall provide all necessary rules and regulations as are required for the proper application of the laws and policies of the U.S. Government regarding—

(a) Elimination in agreements between domestic concerns and foreign governments or foreign concerns of charges for the use of patents in which the U.S. Government has a royalty-free license or of charges in agreements for the use of data that the U.S. Government has a right to use and disclose to others, that is in the public domain, or that was acquired by the U.S. Government with the unrestricted right to use, duplicate, or disclose and to have or permit others to do so;

(b) Foreign license and technical assistance agreements between the U.S. Government and United States domestic concerns;

(c) Guidance on negotiating contract prices and terms concerning patents and data, including royalties, in contracts between the U.S. Government and a foreign government or foreign concern; and

(d) Regulations and guidance on controls on the exportation of data relating to certain designated items, such as arms or munitions of war, and guidance on reviews of agreements involving such data (see 22 CFR part 124).

PART 28—BONDS AND INSURANCE**Sec.**

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- 28.102-3 Solicitation requirements.
- 28.103 Performance and payment bonds for other than construction contracts.
- 28.103-1 General.
- 28.103-2 Performance bonds.
- 28.103-3 Payment bonds.
- 28.104 Annual performance bonds.
- 28.105 Other types of bonds.
- 28.105-1 Advance payment bonds.
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Subpart 28.3—Insurance

- 28.301 Policy.
- 28.302 Notice of cancellation or change.
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Sec.

28.311-3 Agency solicitation provisions and contract clauses.

28.312 Contract clause for insurance of leased motor vehicles.

28.313 Contract clauses for insurance of transportation or transportation-related services.

AUTHORITY: 40 U.S.C. 486(c); 10 U.S.C. Chapter 137; and 42 U.S.C. 2473(c).

SOURCE: 48 FR 42286, Sept. 19, 1983, unless otherwise noted.

28.000 Scope of part.

This part prescribes requirements for obtaining financial protection against damages under sealed bid and negotiated contracts. It covers bid guarantees, bonds, sureties, and insurance. The terms *bid* and *bidders* include *proposal* and *offerors*.

[48 FR 42286, Sept. 19, 1983, as amended at 50 FR 1743, Jan. 11, 1985; 50 FR 52429, Dec. 23, 1985]

28.001 Definitions.

Attorney-in-fact, as used in this part, means an agent, independent agent, underwriter, or any other company or individual holding a power of attorney granted by a surety (see also *power of attorney*).

Bid guarantee means a form of security assuring that the bidder (a) will not withdraw a bid within the period specified for acceptance and (b) will execute a written contract and furnish required bonds, including any necessary coinsurance or reinsurance agreements, within the time specified in the bid, unless a longer time is allowed, after receipt of the specified forms.

Bond means a written instrument executed by a bidder or contractor (the *principal*), and a second party (the *surety* or *sureties*), to assure fulfillment of the principal's obligations to a third party (the *obligee* or *Government*), identified in the bond. If the principal's obligations are not met, the bond assures payment, to the extent stipulated, of any loss sustained by the obligee. The types of bonds and related documents are as follows:

(a) An advance payment bond secures fulfillment of the contractor's obligations under an advance payment provision.

(b) An annual bid bond is a single bond furnished by a bidder, in lieu of separate bid bonds, which secures all bids (on other than construction contracts) requiring bonds submitted during a specific Government fiscal year.

(c) An annual performance bond is a single bond furnished by a contractor, in lieu of separate performance bonds, to secure fulfillment of the contractor's obligations under contracts (other than construction contracts) requiring bonds entered into during a specific Government fiscal year.

(d) A patent infringement bond secures fulfillment of the contractor's obligations under a patent provision.

(e) A payment bond assures payments as required by law to all persons supplying labor or material in the prosecution of the work provided for in the contract.

(f) A performance bond secures performance and fulfillment of the contractor's obligations under the contract.

Consent of surety means an acknowledgment by a surety that its bond given in connection with a contract continues to apply to the contract as modified.

Insurance, as used in this part, means a contract which provides that for a stipulated consideration, one party undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event.

Penal sum or *penal amount* means the amount of money specified in a bond (or a percentage of the bid price in a bid bond) as the maximum payment for which the surety is obligated.

Power of attorney, as used in this part, means the authority given one person or corporation to act for and obligate another, as specified in the instrument creating the power; in corporate suretyship, an instrument under seal which appoints an attorney-in-fact to act in behalf of a surety company in signing bonds (see also *attorney-in-fact*).

Reinsurance means a transaction which provides that a surety, for a consideration, agrees to indemnify another surety against loss which the

latter may sustain under a bond which it has issued.

Surety means an individual or corporation legally liable for the debt, default, or failure of a principal to satisfy a contractual obligation. The types of sureties referred to are as follows:

(a) An individual surety is one person, as distinguished from a business entity, who is liable for the entire penal amount of the bond.

(b) A corporate surety is licensed under various insurance laws and, under its charter, has legal power to act as surety for others.

(c) A cosurety is one of two or more sureties that are jointly liable for the penal sum of the bond. A limit of liability for each surety may be stated.

Subpart 28.1—Bonds

28.100 Scope of subpart.

This subpart prescribes requirements and procedures for the use of bonds and all types of bid guarantees.

28.101 Bid guarantees.

28.101-1 Policy on use.

(a) A contracting officer shall not require a bid guarantee unless a performance bond or a performance and payment bond is also required (see 28.102 and 28.103). Except as provided in paragraph (c) of this subsection, bid guarantees shall be required whenever a performance bond or a performance and payment bond is required.

(b) All types of bid guarantees are acceptable for supply or service contracts (see annual bid bonds and annual performance bonds coverage in 28.001). Only separate bid guarantees are acceptable in connection with construction contracts. Agencies may specify that only separate bid bonds are acceptable in connection with construction contracts.

(c) The chief of the contracting office may waive the requirement to obtain a bid guarantee when a performance bond or a performance and payment bond is required if it is deter-

Class waivers may be authorized by the agency head or designee.

[48 FR 42286, Sept. 19, 1983, as amended at 51 FR 2665, Jan. 17, 1986; 52 FR 19803, May 27, 1987; 52 FR 30076, Aug. 12, 1987; 54 FR 34755, Aug. 21, 1989]

28.101-2 Amount required.

The contracting officer shall determine a bid guarantee amount that is adequate to protect the Government from loss should the successful bidder fail to execute further contractual documents and bonds as required. The bid guarantee amount shall be at least 20 percent of the bid price but shall not exceed \$3 million. When the penal sum is expressed as a percentage, a maximum dollar limitation may be stated.

28.101-3 Contract clause.

(a) When a bid guarantee is required, the solicitation shall contain a statement to that effect, and provide sufficient details for bidders to determine the amount of the bid guarantee.

(b) The contracting officer shall insert the clause at 52.228-1, Bid Guarantee, in solicitations and contracts that contain a requirement for a bid guarantee. A clause substantially the same as this may be used for negotiated contracts. This clause may be appropriately modified for use in connection with construction solicitations and contracts when the agency has specified that only separate bid bonds are acceptable in accordance with 28.101-1(b).

[48 FR 42286, Sept. 19, 1983, as amended at 52 FR 19803, May 27, 1987]

28.101-4 Noncompliance with bid guarantee requirements.

(a) In sealed bidding, noncompliance with a solicitation requirement for a bid guarantee requires rejection of the bid, except in the situations described in paragraph (c) of this subsection when the noncompliance shall be waived.

(b) In negotiation, noncompliance with a solicitation requirement for a

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without discussion, except in the situations described in paragraph (c) of this subsection when noncompliance shall be waived. (See 15.610(a) for conditions regarding making awards based on initial proposals.) If the conditions for awarding based on initial proposals are not met, deficiencies in bid guarantees submitted by offerors determined to be in the competitive range shall be addressed during discussions and the offeror shall be given an opportunity to correct the deficiency.

(c) Noncompliance with a solicitation requirement for a bid guarantee shall be waived in the following circumstances unless the contracting officer determines in writing that acceptance of the bid would be detrimental to the Government's interest when—

(1) Only one offer is received. In this case, the contracting officer may require the furnishing of the bid guarantee before award;

(2) The amount of the bid guarantee submitted is less than required, but is equal to or greater than the difference between the offer price and the next higher acceptable offer;

(3) The amount of the bid guarantee submitted, although less than that required by the solicitation for the maximum quantity offered, is sufficient for a quantity for which the offeror is otherwise eligible for award. Any award to the offeror shall not exceed the quantity covered by the bid guarantee;

(4) The bid guarantee is received late, and late receipt is waived under 14.304;

(5) A bid guarantee becomes inadequate as a result of the correction of a mistake under 14.406 (but only if the bidder will increase the bid guarantee to the level required for the corrected bid);

(6) A telegraphic offer modification is received without corresponding modification of the bid guarantee, if the modification expressly refers to the previous offer and the offeror corrects any deficiency in bid guarantee;

(7) An otherwise acceptable bid bond was submitted with a signed offer, but the bid bond was not signed by the offeror;

(8) An otherwise acceptable bid bond is erroneously dated or bears no date at all; or

(9) A bid bond does not list the United States as obligee, but correctly identifies the offeror, the solicitation number, and the name and location of the project involved, so long as it is acceptable in all other respects.

[54 FR 48985, Nov. 28, 1989]

28.102 Performance and payment bonds for construction contracts.

28.102-1 General.

(a) The Miller Act (40 U.S.C. 270a-270f) requires performance and payment bonds for any construction contract exceeding \$25,000, except that this requirement may be waived (1) by the contracting officer for as much of the work as is to be performed in a foreign country upon finding that it is impracticable for the contractor to furnish such bond, or (2) as otherwise authorized by the Miller Act or other law.

(b) The contractor shall furnish all bonds, including any necessary reinsurance agreements, before receiving a notice to proceed with the work or being allowed to start work.

28.102-2 Amount required.

(a) *Performance bonds.* (1) The penal amount of performance bonds shall be 100 percent of the original contract price, unless the contracting officer determines that a lesser amount would be adequate for the protection of the Government.

(2) The Government may require additional performance bond protection when a contract price is increased. The increase in protection shall generally equal 100 percent of the increase in contract price. The Government may secure additional protection by directing the contractor to increase the penal amount of the existing bond or to obtain an additional bond.

(b) *Payment bonds.* (1) The penal amount of payment bonds shall equal—

(i) Fifty percent of the contract price if the contract price is not more than \$1 million;

(ii) Forty percent of the contract price if the contract price is more than \$1 million but not more than \$5 million; or

(iii) Two and one half million if the contract price is more than \$5 million.

(2) If the original contract price is \$5 million or less, the Government may require additional protection if the contract price is increased. The penal amount of the total protection as revised shall meet the requirement of subparagraph (1) immediately above.

(3) The Government shall secure additional protection by directing the contractor to increase the penal sum of the existing bond or to obtain an additional bond.

(c) *Requirements and indefinite-quantity contracts.* (1) When determining the penal sum of bonds for requirements contracts, the contracting officer shall consider the contract price to be the price payable for the estimated quantity.

(2) When determining the penal sum of bonds for indefinite-quantity contracts, the contracting officer shall consider the contract price to be the price payable for the specified minimum quantity. When the minimum quantity is exceeded, subparagraphs (a)(2) and (b)(2) above apply.

28.102-3 Solicitation requirements.

When performance or payment bonds are required, the solicitation shall specify—

(a) The requirement for the bond(s);

(b) The penal sum of each bond (expressed either as a fixed sum or percentage of the contract price) or penal coverage required in case of annual bonds; and

(c) The deadline for submitting acceptable bonds.

28.103 Performance and payment bonds for other than construction contracts.

28.103-1 General.

(a) Generally, agencies shall not require performance and payment bonds for other than construction contracts. However, performance and payment bonds may be used as permitted in 28.103-2 and 28.103-3.

(b) The contractor shall furnish all bonds before receiving a notice to proceed with the work.

(c) No bond shall be required after the contract has been awarded if it was not specifically required in the contract, except as may be determined necessary for a contract modification.

28.103-2 Performance bonds.

(a) Performance bonds may be required when necessary to protect the Government's interest. The following situations may warrant a performance bond:

(1) Government property or funds are to be provided to the contractor for use in performing the contract or as partial compensation (as in retention of salvaged material).

(2) A contractor sells assets to or merges with another concern, and the Government, after recognizing the latter concern as the successor in interest, desires assurance that it is financially capable.

(3) Substantial progress payments are made before delivery of end items starts.

(4) Contracts are for dismantling, demolition, or removal of improvements.

(b) When a performance bond is required, the solicitation shall contain the information in 28.102-3.

(c) The Government may require additional performance bond protection when a contract price is increased.

(d) The contracting officer must determine the contractor's responsibility (see subpart 9.1) even though a bond has been or can be obtained.

28.103-3 Payment bonds.

(a) A payment bond is required only when a performance bond is required, and if the use of payment bond is in the Government's interest.

(b) The contracting officer shall determine the penal amount of a payment bond.

(c) When a payment bond is required, the solicitation shall contain the information in 28.102-3.

(d) When a contract price is increased, the Government may require additional bond protection in an

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amount adequate to protect suppliers of labor and material.

28.104 Annual performance bonds.

(a) Annual performance bonds only apply to non-construction contracts. They shall provide a gross penal sum applicable to the total amount of all covered contracts.

(b) When the penal sums obligated by contracts are approximately equal to or exceed the penal sum of the annual performance bond, an additional bond will be required to cover additional contracts.

28.105 Other types of bonds.

The head of the contracting activity may approve using other types of bonds in connection with acquiring particular supplies or services. These types include advance payment bonds and patent infringement bonds.

28.105-1 Advance payment bonds.

Advance payment bonds may be required only when the contract contains an advance payment provision and a performance bond is not furnished. The contracting officer shall determine the amount of the advance payment bond necessary to protect the Government.

28.105-2 Patent infringement bonds.

(a) Contracts providing for patent indemnity may require these bonds only if—

(1) A performance bond is not furnished; and

(2) The financial responsibility of the contractor is unknown or doubtful.

(b) The contracting officer shall determine the penal sum.

28.106 Administration.

28.106-1 Bonds and bond related forms.

The following Standard Forms (SF's) and Optional Forms (OF's) shown in 53.301 and 53.302 shall be used, except in foreign countries, when a bid bond, performance or payment bond, or an individual surety is required. The bond forms shall be used as indicated in the instruction portion of each form.

(a) SF 24, Bid Bond (see 28.101).

(b) SF 25, Performance Bond (see 28.102-1 and 28.106-3(b)).

(c) SF 25-A, Payment Bond (see 28.103-3 and 28.106-3(b)).

(d) SF 25-B, Continuation Sheet (for SF's 24, 25, and 25-A).

(e) SF 28, Affidavit of Individual Surety (see 28.203).

(f) SF 34, Annual Bid Bond (see 28.001).

(g) SF 35, Annual Performance Bond (see 28.104).

(h) SF 273, Reinsurance Agreement for a Miller Act Performance Bond (see 28.202(a)(4)).

(i) SF 274, Reinsurance Agreement for a Miller Act Payment Bond (see 28.202(a)(4)).

(j) SF 275, Reinsurance Agreement in Favor of the United States (see 28.202(a)(4)).

(k) SF 1414, Consent of Surety (see 28.106-5).

(l) SF 1415, Consent of Surety and Increase of Penalty (see 28.106-3).

(m) SF 1416, Payment Bond for Other Than Construction Contracts (see 28.103-3).

(n) OF 90, Release of Lien on Real Property (see 28.203-5).

(o) OF 91, Release of Personal Property from Escrow (see 28.203-5).

[48 FR 42286, Sept. 19, 1983, as amended at 54 FR 48986, Nov. 28, 1989]

28.106-2 Substitution of surety bonds.

(a) A new surety bond covering all or part of the obligations on a bond previously approved may be substituted for the original bond if approved by the head of the contracting activity.

(b) When a new surety bond is approved, the contracting officer shall notify the principal and surety of the original bond of the effective date of the new bond.

28.106-3 Additional bond.

(a) When additional bond coverage is required and is furnished in whole or in part by the original surety or sureties, agencies shall use Standard Form 1415, Consent of Surety and Increase of Penalty. Standard Form 1415 is authorized for local reproduction, and a copy of the form is furnished for this purpose in part 53 of the looseleaf edition of the FAR.

(b) When additional coverage is furnished in whole or in part by a new surety, agencies shall use Standard Form 25, Performance Bond or Standard Form 25-A, Payment Bond.

[48 FR 42286, Sept. 19, 1983, as amended at 53 FR 43391, Oct. 26, 1988]

28.106-4 Contract clause.

The contracting officer shall insert the clause at 52.228-2, Additional Bond Security, in solicitations and contracts when bonds are required.

28.106-5 Consent of surety.

(a) When any contract is modified, the contracting officer shall obtain the consent of surety if—

(1) An additional bond is obtained from other than the original surety;

(2) No additional bond is required and—

(i) The modification is for new work beyond the scope of the original contract; or

(ii) The modification does not change the contract scope but changes the contract price (upward or downward) by more than 25 percent or \$50,000; or

(3) Consent of surety is required for a novation agreement (See subpart 42.12).

(b) Agencies shall use Standard Form 1414, Consent of Surety, for all types of contracts.

28.106-6 Furnishing information.

(a) The surety on the bond, upon its written request, may be furnished in-

(c) When a payment bond has been provided for a contract, the head of the agency or designee shall furnish a certified copy of the bond and the contract for which it was given to any person who makes a request therefor and who furnishes an affidavit that the requestor has supplied labor or materials for such work and payment therefor has not been made or that the requestor is being sued on such bond. The person who makes the request shall be required to pay such costs of preparation as determined by the head of the agency or designee to be reasonable and appropriate (see 40 U.S.C. 270(c)).

[48 FR 42286, Sept. 19, 1983, as amended at 50 FR 26903, June 28, 1985]

28.106-7 Withholding contract payments.

(a) During contract performance, agencies shall not withhold payments due contractors or assignees because subcontractors or suppliers have not been paid.

(b) If, after completion of the contract work, the Government receives written notice from the surety regarding the contractor's failure to meet its obligation to its subcontractors or suppliers, the contracting officer shall withhold final payment. However, the surety must agree to hold the Government harmless from any liability resulting from withholding the final payment. The contracting officer will authorize final payment upon agreement between the contractor and surety or upon a judicial determination of the rights of the parties.

tion). Acceptable forms of security include (1) corporate or individual sureties or (2) any of the types of security authorized in lieu of sureties by 28.204.

(b) Solicitations shall not preclude offerors from using the types of surety or security permitted by this subpart, unless prohibited by law or regulation.

[48 FR 42286, Sept. 19, 1983, as amended at 55 FR 25530, June 21, 1990]

28.202 Acceptability of corporate sureties.

(a)(1) Corporate sureties offered for bonds furnished with contracts performed in the United States, its possessions, or Puerto Rico must appear on the list contained in the Department of the Treasury Circular 570, "Companies Holding Certificates of Authority as Acceptable Sureties on Federal Bonds and Acceptable Reinsuring Companies."

(2) The penal amount of the bond should not exceed the surety's underwriting limit stated in the Department of the Treasury circular. If the penal amount exceeds the underwriting limit, the bond will be acceptable only if (i) the amount which exceeds the specified limit is coinsured or reinsured and (ii) the amount of coinsurance or reinsurance does not exceed

calendar days after the execution of the bond. The contractor shall use Standard Form 273, Reinsurance Agreement for a Miller Act Performance Bond, and Standard Form 274, Reinsurance Agreement for a Miller Act Payment Bond, when reinsurance is furnished with Miller Act bonds. Standard Form 275, Reinsurance Agreement in Favor of the United States, is used when reinsurance is furnished with bonds for other purposes.

(b) For contracts performed in a foreign country, sureties not appearing on Treasury Department Circular 570 are acceptable if the contracting officer determines that it is impracticable for the contractor to use Treasury listed sureties.

(c) The Department of the Treasury issues supplements to Circular 570, notifying all Federal agencies of (1) new approved corporate surety companies and (2) the termination of the authority of any specific corporate surety to qualify as a surety on Federal bonds. Upon receipt of notification of termination of a company's authority to qualify as a surety on Federal bonds, the contracting officer shall review the outstanding contracts and take action necessary to protect the Gov-

(b) An individual surety must execute the bond, and the unencumbered value of the assets (exclusive of all outstanding pledges for other bond obligations) pledged by the individual surety, must equal or exceed the penal amount of each bond. The individual surety shall execute the Standard Form 28 and provide a security interest in accordance with 28.203-1. One individual surety is adequate support for a bond, provided the unencumbered value of the assets pledged by that individual surety equal or exceed the amount of the bond. An offeror may submit up to three individual sureties for each bond, in which case the pledged assets, when combined, must equal or exceed the penal amount of the bond. Each individual surety must accept both joint and several liability to the extent of the penal amount of the bond.

(c) If the contracting officer determines that no individual surety in support of a bid guarantee is acceptable, the offeror utilizing the individual surety shall be rejected as nonresponsible, except as provided in 28.101-4. A finding of nonresponsibility based on unacceptability of an individual surety, need not be referred to the Small Business Administration for a competency review. (See 19.602-1(a)(2)(i) and 61 Comp. Gen. 456 (1982).)

(d) A contractor submitting an unacceptable individual surety in satisfaction of a performance or payment bond requirement may be permitted a reasonable time, as determined by the contracting officer, to substitute an acceptable surety for a surety previously determined to be unacceptable.

(e) When evaluating individual sureties, contracting officers may obtain assistance from the office identified in 28.202(d).

(f) Contracting officers shall obtain the opinion of legal counsel as to the adequacy of the documents pledging the assets prior to accepting the bid guarantee and payment and performance bonds.

(g) Evidence of possible criminal or fraudulent activities by an individual surety shall be referred to the appropriate agency official in accordance with agency procedures.

[54 FR 48986, Nov. 28, 1989]

28.203-1 Security interests by an individual surety.

(a) An individual surety may be accepted only if a security interest in assets acceptable under 28.203-2 is provided to the Government by the individual surety. The security interest shall be furnished with the bond.

(b) The value at which the contracting officer accepts the assets pledged must be equal to or greater than the aggregate penal amounts of the bonds required by the solicitation and may be provided by one or a combination of the following methods:

(1) An escrow account with a federally insured financial institution in the name of the contracting agency. (See 28.203-2(b)(2) with respect to Government securities in book entry form.) Acceptable securities for deposit in escrow are discussed in 28.203-2. While the offeror is responsible for establishing the escrow account, the terms and conditions must be acceptable to the contracting officer. At a minimum, the escrow account shall provide for the following:

(i) The account must provide the contracting officer the sole and unrestricted right to draw upon all or any part of the funds deposited in the account. A written demand for withdrawal shall be sent to the financial institution by the contracting officer, after obtaining the concurrence of legal counsel, with a copy to the offeror/contractor and to the surety. Within the time period specified in the demand, the financial institution would pay the Government the amount demanded up to the amount on deposit. If any dispute should arise between the Government and the offeror/contractor, the surety, or the subcontractors or suppliers with respect to the offer or contract, the financial institution would be required, unless precluded by order of a court of competent jurisdiction, to disburse monies to the Government as directed by the contracting officer.

(ii) The financial institution would be authorized to release to the individual surety all or part of the balance of the escrow account, including any accrued interest, upon receipt of written

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authorization from the contracting officer.

(iii) The Government would not be responsible for any costs attributable to the establishment, maintenance, administration, or any other aspect of the account.

(iv) The financial institution would not be liable or responsible for the interpretation of any provisions or terms and conditions of the solicitation or contract.

(v) The financial institution would provide periodic account statements to the contracting officer.

(vi) The terms of the escrow account could not be amended without the consent of the contracting officer.

(2) A lien on real property, subject to the restrictions in 28.203-2 and 28.203-3.

[54 FR 48986, Nov. 28, 1989]

28.203-2 Acceptability of assets.

(a) The Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations.

(b) Acceptable assets include—

(1) Cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution;

(2) United States Government securities at market value. (An escrow account is not required if an individual surety offers Government securities held in book entry form at a depository institution. In lieu thereof, the individual shall provide evidence that the depository institution has (i) placed a notation against the individual's book entry account indicating that the security has been pledged in favor of the respective agency; (ii) agreed to notify the agency prior to maturity of the security; and (iii) agreed to hold the proceeds of the security subject to the pledge in favor of the agency until a substitution of securities is made or the security interest is formally released by the agency);

(3) Stocks and bonds actively traded on a national U.S. security exchange with certificates issued in the name of the individual surety. National security exchanges are—(i) the New York Stock Exchange; (ii) the American

Stock Exchange; (iii) the Boston Stock Exchange; (iv) the Cincinnati Stock Exchange; (v) the Midwest Stock Exchange; (vi) the Philadelphia Stock Exchange; (vii) the Pacific Stock Exchange; and (viii) the Spokane Stock Exchange. These assets will be accepted at 90 percent of their 52-week low, as reflected at the time of submission of the bond. Stock options and stocks on the over-the-counter (OTC) market or NASDAQ Exchanges will not be accepted. Assistance in evaluating the acceptability of securities may be obtained from the Securities and Exchange Commission, Division of Enforcement, 450 Fifth Street NW., Washington, DC 20549.

(4) Real property owned in fee simple by the surety without any form of concurrent ownership, except as provided in subdivision (c)(3)(iii) of this subsection, and located within the 50 United States, its territories, or possessions. These assets will be accepted at 100 percent of the most current tax assessment value (exclusive of encumbrances) or 75 percent of the properties' unencumbered market value provided a current appraisal is furnished (see 28.203-3).

(5) Irrevocable letters of credit (ILC) issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number for which the ILC is provided.

(c) Unacceptable assets include but are not limited to—

(1) Notes or accounts receivable;

(2) Foreign securities;

(3) Real property as follows:

(i) Real property located outside the United States, its territories, or possessions.

(ii) Real property which is a principal residence of the surety.

(iii) Real property owned concurrently regardless of the form of co-tenancy (including joint tenancy, tenancy by the entirety, and tenancy in common) except where all co-tenants agree to act jointly.

(iv) Life estates, leasehold estates, or future interests in real property.

(4) Personal property other than that listed in paragraph (b) of this subsection (e.g., jewelry, furs, antiques);

(5) Stocks and bonds of the individual surety in a controlled, affiliated, or closely held concern of the offeror/contractor;

(6) Corporate assets (e.g., plant and equipment);

(7) Speculative assets (e.g., mineral rights);

(8) Letters of credit, except as provided in 28.203-2(b)(5).

[54 FR 48987, Nov. 28, 1989]

28.203-3 Acceptance of real property.

(a) Whenever a bond with a security interest in real property is submitted, the individual surety shall provide—

(1) Evidence of title in the form of a certificate of title prepared by a title insurance company approved by the United States Department of Justice. This list entitled List of Approved Attorneys, Abstracters, and Title Companies is available from the Title Unit, Land Acquisition Section, Land and Natural Resource Division, Depart-

(d) The following format, or any document substantially the same, shall be used by the surety and recorded in the local recorder's office when a surety pledges real estate on Standard Form 28, Affidavit of Individual Surety.

LIEN ON REAL ESTATE

I/we agree that this instrument constitutes a lien in the amount of \$----- on the property described in this lien. The rights of the United States Government shall take precedence over any subsequent lien or encumbrance until the lien is formally released by a duly authorized representative of the United States. I/we hereby grant the United States the power of sale of subject property, including the right to satisfy its reasonable administrative costs, including legal fees associated with any sale of subject property, in the event of contractor default if I/we otherwise fail to satisfy the underlying

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28.203-4 Substitution of assets.

An individual surety may request the Government to accept a substitute asset for that currently pledged by submitting a written request to the responsible contracting officer. The contracting officer may agree to the substitution of assets upon determining, after consultation with legal counsel, that the substitute assets to be pledged are adequate to protect the outstanding bond or guarantee obligations. If acceptable, the substitute assets shall be pledged as provided for in subpart 28.2.

[54 FR 48988, Nov. 28, 1989]

28.203-5 Release of lien.

(a) After consultation with legal counsel, the contracting officer shall release the security interest on the individual surety's assets using the Optional Form 90, Release of Lien on Real Property, or Optional Form 91, Release of Personal Property from Escrow, or a similar release as soon as possible consistent with the conditions in subparagraphs (a) (1) and (2) of this subsection. A surety's assets pledged in support of a payment bond may be released to a subcontractor or supplier upon Government receipt of a Federal district court judgment, or a sworn statement by the subcontractor or supplier that the claim is correct along with a notarized authorization of the release by the surety stating that it approves of such release.

(1) *Contracts subject to the Miller Act.* The security interest shall be maintained for the later of (i) 1 year following final payment, (ii) until completion of any warranty period (applicable only to performance bonds), or (iii) pending resolution of all claims filed against the payment bond during the 1-year period following final payment.

(2) *Contracts not subject to the Miller Act.* The security interest shall be maintained for 90 days following final payment or until completion of any warranty period (applicable only to performance bonds), whichever is later.

(b) Upon written request, the contracting officer may release the security interest on the individual surety's

assets in support of a bid guarantee based upon evidence that the offer supported by the individual surety will not result in contract award.

(c) Upon written request by the individual surety, the contracting officer may release a portion of the security interest on the individual surety's assets based upon substantial performance of the contractor's obligations under its performance bond. Release of the security interest in support of a payment bond must comply with the subparagraphs (a) (1) and (2) of this subsection. In making this determination, the contracting officer will give consideration as to whether the unreleased portion of the lien is sufficient to cover the remaining contract obligations, including payments to subcontractors and other potential liabilities. The individual surety shall, as a condition of the partial release, furnish an affidavit agreeing that the release of such assets does not relieve the individual surety of its obligations under the bond(s).

[54 FR 48988, Nov. 28, 1989]

28.203-6 Contract clause.

Insert the clause at 52.228-11 in solicitations and contracts which require the submission of bid guarantees, performance, or payment bonds.

[54 FR 48988, Nov. 28, 1989]

28.203-7 Exclusion of individual sureties.

(a) An individual may be excluded from acting as a surety on bonds submitted by offerors on procurement by the executive branch of the Federal Government, by the acquiring agency's head or designee utilizing the procedures in subpart 9.4. The exclusion shall be for the purpose of protecting the Government.

(b) An individual may be excluded for any of the following causes:

(1) Failure to fulfill the obligations under any bond.

(2) Failure to disclose all bond obligations.

(3) Misrepresentation of the value of available assets or outstanding liabilities.

(4) Any false or misleading statement, signature or representation on a

bond or affidavit of individual suretyship.

(5) Any other cause affecting responsibility as a surety of such serious and compelling nature as may be determined to warrant exclusion.

(c) An individual surety excluded pursuant to this subsection shall be included on the list entitled Parties Excluded from Procurement Programs. (See 9.404.)

(d) Contracting officers shall not accept the bonds of individual sureties whose names appear on the list entitled Parties Excluded from Procurement Programs (see 9.404) unless the acquiring agency's head or a designee states in writing the compelling reasons justifying acceptance.

(e) An exclusion of an individual surety under this subsection will also preclude such party from acting as a contractor in accordance with subpart 9.4.

[54 FR 48988, Nov. 28, 1989]

28.204 Options in lieu of sureties.

The contractor may deposit any of the types of security listed in this section instead of furnishing corporate or individual sureties on performance and payment bonds. When any of those types of security are deposited, a statement shall be incorporated in the bond form pledging the security. The contractor shall execute the bond forms as the principal. Agencies shall establish safeguards to protect against loss of the security and shall return the security or its equivalent to the contractor when the bond obligation has ceased.

[48 FR 42286, Sept. 19, 1983. Redesignated at 54 FR 48986, Nov. 28, 1989]

28.204-1 United States bonds or notes.

Any person required to furnish a bond to the Government has the option, instead of furnishing a surety or sureties on the bond, of depositing certain United States bonds or notes

authorizing the collection or sale of such United States bonds or notes in the event of default of the principal on the bond shall accompany the deposited bonds or notes. The contracting officer may (a) turn securities over to the finance or other authorized agency official, or (b) deposit them with the Treasurer of the United States, a Federal Reserve Bank (or branch with requisite facilities), or other depository designated for that purpose by the Secretary of the Treasury, under procedures prescribed by the agency concerned and Treasury Department Circular No. 154 (exception: The contracting officer shall deposit all bonds and notes received in the District of Columbia with the Treasurer of the United States).

[48 FR 42286, Sept. 19, 1983. Redesignated and amended at 54 FR 48986, 48989, Nov. 28, 1989]

28.204-2 Certified or cashiers checks, bank drafts, money orders, or currency.

Any person required to furnish a bond has an option to furnish a certified or cashier's check, bank draft, Post Office money order, or currency, in an amount equal to the penal sum of the bond, instead of furnishing surety or sureties on the bonds. Those furnishing checks, drafts, or money orders shall draw them to the order of the appropriate Federal agency.

[48 FR 42286, Sept. 19, 1983. Redesignated at 54 FR 48986, Nov. 28, 1989]

Subpart 28.3—Insurance

28.301 Policy.

Contractors shall be required to carry insurance under the following circumstances:

(a) (1) The Government requires any contractor subject to Cost Accounting Standard (CAS) 416 (4 CFR part 416) to obtain insurance, by purchase or

contract damage

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securities agency, call 202/737-0900.) A call to the Better Business Bureau in the city in which the firm is located may turn up calls from investors who have been victimized.

If you suspect that you have been contacted by a phone scammer, notify your state securities office of the firm and the name of the salesman. Prompt action on your part may protect less wary investors.

Many investments promoted over the phone are legitimate. The wise investor will follow these simple steps in order to be able to distinguish the "good" from the "bad" in telephone solicitations.

"WIRELESS CABLE" TV LOTTERY APPLICATION MILLS

[¶ 8225]

April 1992

When the federal government holds a lottery, con artists are among those who profit the most. High-pressure telemarketing **application mills**¹ first emerged in the 1970s to fleece investors out of millions of dollars with overblown promises about the likelihood of scoring huge riches in the U.S. Bureau of Land Management's oil and gas lease lottery program. In the 1980s, shady application preparation services misled thousands of small investors about their prospects of being "winners" in the cellular telephone license lotteries held by the Federal Communications Commission (FCC). Today, the FCC lottery process for awarding **"wireless cable" television** licenses in markets across the U.S. has led to an explosion in abusive application mills that seek to reel in unwary small investors with the lure of the latest in high tech and the promises of quick riches.

State securities regulators around the U.S. are reporting that abusive sales pitches from wireless cable television lottery application mills now account for their **single fastest-growing telemarketing "problem" category for small investors**. Application preparation services preying on the FCC wireless cable television lottery have raked in **\$50 million or more** to date and, with the rapidly accelerating growth in such abuses, likely will separate small investors from **another \$25 million during 1992**. Hyped as **"the best kept investment secret in telecommunications"** and **"television's last frontier,"** wireless cable is being promoted today through a sophisticated array of telemarketing boiler room pitches, seminars, direct mail solicitations and advertisements, including **"infomercials,"** that appear on radio and television and in the classified sections of newspapers. While the FCC lottery process **itself** is not fraudulent or misleading, it (like the major federal lotteries before it) has been seized upon by illicit telemarketers as **a ready vehicle for fraud and abuse**.

Wireless cable—also known as Multichannel Multipoint Distribution Service (MMDS)—uses microwave radio technology to transmit non-broadcast programming (such as HBO and ESPN) directly to a small antenna attached to a subscriber's roof. As a competitive alternative to traditional "hard-wired" cable, for which thousands of dollars must be spent to run coaxial cable to individual homes, **legitimate** licenses awarded through the lottery process. The prospects for these multi-million dollar

¹ The term "application mill" is used because the telemarketing operations in question are estab-

lished in order to **grind out** massive numbers of lottery applications.

"windfalls" are slim, since industry interest in rural markets has been spotty and, when present, not as lucrative as was the case with the earlier round of metropolitan markets.

- That a lottery winner will advance from "conditional" license to final "certificate of completion" is far from a certainty. Wireless cable television lottery data provided by the FCC in late 1991 indicated that of the 1180

wireless cable industry mean this investment is not for the faint of heart—or those unable to bear losing up to 100 percent loss of their capital.

WIRELESS CABLE MILL ABUSES MOUNTING . . .

Application mills inflate the prospects for an investor to prevail in a wireless cable television lottery, gloss over the complicated mechanics of the FCC lottery process, understate the risks, exaggerate the potential value of a license, overstate the availability of necessary financing, and make it seem that fat profits are all but certain and will start rolling in almost immediately. To date, at least 17 state securities agencies—**Arizona, Alaska, Alabama, California, Hawaii, Idaho, Massachusetts, Michigan, Mississippi, Missouri, Nevada, New Hampshire, North Dakota, Rhode Island, South Dakota, and Washington state**—have investigated or taken formal actions against suspect application preparation firms promoting the wireless cable television lottery. A special survey conducted during January-February 1992 of the files of state securities agencies and Better Business Bureaus across the U.S. turned up the following cases:

- A **Bismark, N.D.**, couple got a call in October 1991, from a Sacramento, CA., telemarketing operation peddling wireless cable lottery applications. The firm indicated that a \$5,000 investment in an application would yield a winning license and a *\$2,500 monthly income* within the first year of operation, according to the investigation by the **North Dakota Securities Commissioner**. How had the couple been singled out for the phone pitch? The California company purchased the list of those who had stayed recently at a resort in Reno, NV., where the husband had attended a business convention. Apparently, the firm assumed that *people who gambled at casinos would be good prospects for the services of a wireless cable lottery application mill*.
- When the **Securities Division of the Massachusetts Secretary of State** sent in an undercover agent to work in a boiler room promoting the application mill services of a **Nevada**-based firm, it found that potential investors were being told that the wireless cable was being described as a high return, low risk investment. The company also claimed to have devised a means by which an investor, in exchange for a fee of \$6,400, had *65 out of 66 chances of winning* an FCC license—an almost **99 percent** certainty. According to a **Nevada** action, prospective investors were not told that the firm was under **Alaska** and **Massachusetts** cease-and-desist orders and that it was a defendant in a **Michigan** civil lawsuit alleging extensive securities law violations.

Securities regulators around the U.S. are now concerned that illicit telemarketers have started to move on to what may emerge during 1992 as the **"second wave" of serious abuses associated with the FCC's wireless cable television lottery**: High-pressure telemarketing sales pitches seeking investors' funds in order to "build out" wireless cable operations in markets for which the suspect firms *claim* to hold the licenses. These emerging **"post-lottery schemes"** appear to involve many of the same abuses, including inadequate disclosure of risk, solicitation of unsophisticated investors, and overblown projections of profit. There are indications that some of the firms involved actually may be holding *no* MMDS licenses, including the ones for which they are actively soliciting investor funds. Another worry for regulators: Wireless cable **"build out"**

schemes may seem to unwary investors to involve far less risk, since the firms claim to have cleared the first hurdle of "winning" the licenses.

- The Washington State Securities Division took action in June 1991 after the following advertisement appeared in Seattle newspapers.

"PHENOMENAL INCOME. FCC GOVERNMENT PROGRAM. WIRELESS CABLE TV. MINIMUM INVESTMENT \$5-25K TO OBTAIN FCC LICENSE, ACT NOW."

Those who responded to the ad were told that the Irvine, CA., firm involved was selling 4.999 percent interests in individual FCC licenses for \$5,000. (Of course, the firm did not actually have licenses to sell and, at best, could only sell what amounted to a fraction of a lottery "ticket".) Investors who put in \$25,000 were told that they could expect income of \$5,000-\$10,000 a month in the second year of operation and an annual profit of \$62,500.

- Misleading rhetoric is a staple of wireless cable application mills. For example, one "application preparation service" was found in December 1991 by the Securities Division of the Missouri Secretary of State to be promoting itself at trade and franchise shows in the state. Its sales materials described wireless cable as a "break through technology . . . the next generation of television . . . the best of satellite programming, available now, at lower cost." Another company sends investors brochures speaking of "America's most valuable resources—the airwaves" and characterizing the lottery process in the following terms: "Our FCC has historically proven itself as the greatest of all government giveaways. Awarding the airwaves to the American public is like the great land grants of the early 1800s, only this time the real estate is in the sky." The super-heated claims contained in the sales literature distributed by wireless cable mills are quite vivid, but they pale in comparison to what investors may be told over the phone. For example, a salesman at one wireless cable application mill is reported to have told callers: "There's no financial risk. You put down \$6,450 and you can get back \$21,000 a year for the rest of your life." Another salesman at the same firm is said to have explained: "It's a federal giveaway. This is the last of the free, fat cash cows available to the American public."

WIRELESS CABLE LOTTERY "MANIA"

Application mills taking advantage of the FCC's wireless cable lottery did not kick into high gear until 1988 and 1989, though the first applications were taken in by the Commission in 1983. The initial lottery rounds handed out wireless cable television licenses for all of the 250 major metropolitan areas in the U.S. (Even so, there are in operation today fewer than 170 wireless cable systems with a total of 350,000 subscribers.) In 1988, the FCC started accepting applications for the remaining markets. Many of these "second tier" markets are small and predominately rural, in some cases offering only limited prospects due to sparse population and terrain not always suited to wireless cable technology. Nonetheless, the FCC was swamped with applications; the level of 11,205 applications received by the Commission in 1991 was up sharply from the 6,000 in fiscal 1990 and the 200 or so each in 1989 and 1988. It is anticipated that 1992 applications for the wireless cable lottery will set a new one-year record.

The torrent of *almost 36,000 applications* that have flooded in to the FCC wireless cable television lottery to date is attributable almost entirely to the speculative fever whipped up by the pie-in-the-sky sales pitches of a growing number of application mills. As one senior attorney at the Federal Trade Commission (FTC) has noted: **"We're seeing a new variation on using a government program to defraud the public. In my opinion, the only people making money are the sales people."** (To date, the FTC has undertaken three major wireless cable application mill cases, obtaining preliminary injunctions against deceptive sales practices in all three.) Similar concerns about abuses of the FCC lottery process have been expressed by major figures in the legitimate wireless cable industry. Robert Schmidt, president of the Wireless Cable Association (WCA), has complained: **"They're taking our industry name and running it into the ground."**

HOW THE FCC LOTTERY WORKS

In its simplest terms, the FCC wireless cable television lottery is a **"first in, wins"** process, under which the earliest applicant to identify a market and submit a properly completed application for the license to the same is awarded on a **"conditional"** license. If the individual's application withstands more detailed scrutiny by the Commission, he or she is granted a **"certificate of completion"** and is permitted to begin wireless cable television operations. If more than one application is received in **the same 24-hour period for the same market**, the FCC holds a lottery. The exception to this rule comes into play if all the parties interested in the specific market agree to a valid **"settlement"** (sometimes referred to as an **"alliance"**), under which the interest in the license is divided amongst them. If the FCC acknowledges the settlement as a proper one, the lottery for the market is suspended and the license is awarded to the various parties involved in the arrangement. (Individual license awards are rarely touted by application mills, which, instead, emphasize the **"settlement"** route under which those involved supposedly will be able to each get a fat slice of riches.)

An applicant is required to file a long and complex form with the FCC. The submission must include detailed engineering and interference studies. In order to ensure competition, the FCC awards **two licenses for each market** and each license covers **only four channels**. For each four-channel application, a lottery participant must pay a filing fee of \$155, a low amount rarely disclosed by application mills charging thousands of dollars for their **"services"**. The FCC wireless cable lottery is a classic example of something that sounds relatively simple in theory but turns out to be much more convoluted in practice. Many of the nitty-gritty details of the lottery process are glossed over or ignored altogether in the high-pressure sales pitches of the application mills. Consider that:

- The FCC was unprepared for the deluge of wireless cable lottery applications and, until very recently, was still in the process of processing applications from the 1983 lotteries. Even though the lottery is a **"first in, wins"** process, as described above, it is taking the FCC many months and even years to wade through and process the many thousands of backed-up applications.
- Even though a market closes on midnight of the day that the first eligible application is received, the public has no reliable way (short of waiting for what may stretch into months) to learn if the FCC has taken such a final step. As a result, numerous applications may be received for a **"closed"**

market and will be forfeited, with investors getting a refund of neither the \$155 fee nor the additional charges imposed by the application mill.

● The award of a license is not a "blank check" for speculation. A license is automatically invalidated if a station is not constructed and in operation within one year or as otherwise specified. In fact, the speculative nature of the lottery turns on the fact that application mills tempt potential lottery applicants with the prospect that major industry interests will pay top dollars for sections of the country, such as much of Texas and the Great Plains states, while markets in other areas of the U.S. may have little or no potential for the technology.

"WINNING" AN FCC LICENSE IS NO GUARANTEE OF BIG

Wireless Cable Association President Schmidt has noted that those in the bona fide industry (as opposed to fly-by-night application mills) are not looking for the sort of small investors who are likely to respond to a radio or newspaper advertisement asking for \$5,000. Instead, the wireless companies seek wealthy professional investors who: (1) can afford to speculate with tens and even hundreds of thousands of dollars; (2) fully appreciate that they may lose every cent of their capital; and (3) can afford to wait for three, five, or more, years before seeing their first penny of profit, if any.

FEDERAL LOTTERY ABUSES LIKELY TO GET WORSE . . .

Has the federal government learned the lessons of the massive application mill fraud that has surrounded all of its major lotteries in recent years, including those for wireless cable television, cellular telephones, and oil and gas leases? **It may be that these troubled lotteries represent only the beginning of the problem.** New federal lotteries to award market licenses for even newer technology are now either underway or being contemplated:

- Abusive application mills already may have started exploiting the FCC's new lottery process for **multiple address system** (MAS) technology. MAS is touted as a cheaper alternative to point-to-multipoint services that now require that special land lines be leased from local telephone companies. Under MAS, high-frequency radio transmissions and satellites are used to link up a central information source, such as the main computer at a bank or credit card company, to thousands of widely-scattered locations, such as automatic teller machines (ATMs) or grocery stores, where it then is possible to carry out "instant" credit card balance checks and on-line debts. (The latter permits a customer to use an ATM bank card to make a purchase at a store. The merchant processes the bank card much like a credit card, with the difference being that the amount involved is transferred directly from the bank to the merchant.) Shady application mills are likely to jump on MAS for the same reasons that they have exploited the wireless cable television lottery: the appeal to investors of a new high-tech field and the opportunity to speak of potentially huge profits for those who get in on the birth of this new industry.
- More recently, the FCC has set in motion a revised lottery process for **interactive video data services** (IVDS) holding forth the promise of two-way interactive programming. (Under IVDS, a subscriber at home might pick from a menu of events on the television screen and then "order" the screening of a specific event or other program, such as a movie. Various business applications, such as remote control of unmanned commercial production facilities and two-way data transmission from laptop computers, also are contemplated.) The FCC believes that its "abbreviated" filing procedure for the lotteries it intends to hold for 734 IVDS markets across the United States will dampen the speculative fever induced by abusive application mills. Under one reform, the Commission will not allow a license to be sold until a broadcast facility in the market has been constructed to such a point that it can deliver IVDS to at least 50 percent of potential subscribers.

Will the FCC be able to conduct lotteries for MAS and IVDS that will not end up overrun by abusive application preparation services? History is not encouraging in this connection. The experience with the Commission's cellular telephone lotteries, in which "financial wherewithal" requirements were imposed at the eleventh hour in an unsuccessful bid to curb purely speculative applications, suggests that where the federal government holds a lottery, the application mills will find a way to exploit it. Worse, there is evidence that as the federal lotteries multiply, some "old hands" have come to specialize in manipulating them to their advantage. For example, links have been found between some of the application preparation services for the FCC cellular telephone lotteries of the 1980s and those now in operation on the wireless cable front.

It is entirely possible that abuses of the federal lotteries for MAS and IVDS will be overshadowed in the next few years by what is potentially an even greater threat to consumers. Efforts are now afoot in Washington, D.C., to shift a major section of the radio frequency spectrum from public use (such as the military) to private applications, including new and emerging technologies. A heated debate is underway about how the 200 megahertz "slice" of the radio frequency spectrum should be sold off. In spite of all its flaws, the lottery process is defended by its proponents as an opportunity for individual citizens to participate in the process on an equal footing with well-to-do individuals and companies. Under an "auction" or "competitive bidding" process, larger and better-financed interests might come to entirely dominate the proceedings, though one advantage of the latter approach is that available radio frequencies would far more likely be sold for top dollar, thereby providing the cash-strapped federal government with billions of dollars in revenues. It already has been speculated that one way application mills could cash in on an auction process is by assembling tens or even hundreds of individual investors into "syndicates" or "alliances" that supposedly would speak with one voice during the bidding process of an auction. This means many of the current abuses would take place, with only minor "zigs and zags" accounting for the differences between the lotteries held to date and the auction process.

Much of the current debate about selling off a major section of the radio spectrum has focused on the issue of how the federal government might best wring every possible dollar of revenue from the process. However, the outcome may end up having enormous (even if entirely unintended) consequences for consumers; **this new federal licensing process could serve as the biggest bonanza to date for con artists and other sharp operators** who will waste no time in gearing up a new and even bigger generation of application mills. It is difficult to imagine that the same individuals who have seized upon far more modest opportunities for illicit profit in the cellular telephone and wireless cable lotteries would pass up the enormous—though no less fraudulent and abusive—potential that privatizing the radio spectrum will hold for them.

MAKING A COMPLAINT . . .

It may take months or even years before you have direct evidence that you have been ripped-off by a wireless cable television lottery application mill. (Many investment schemes are constructed in such a way that con artists "buy time"—six, 12 or more months—in order to fleece victims before the scam becomes apparent and it is necessary for them to shut down their operations and move to the next town, state or swindle.) If you suspect that you have been defrauded or misled by a wireless cable lottery application mill, contact:

- The **securities division** in the state, province or territory in which you live. The phone number of the securities commission in your jurisdiction is available by contacting the North American Securities Administrators Association (NASAA) at 703/276-0900.
- The **Better Business Bureau** in the city in which the application mill is located. The BBB would be interested in receiving a written version of your complaint and also has available reliability reports on local companies.
- The **Federal Trade Commission**. Write to: "Investment Fraud," Federal Trade Commission, Room 200, 6th and Pennsylvania Avenue NW, Washington, DC 20580.

"CD ALTERNATIVES"—MAKING THE RIGHT CHOICE

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Not long ago, when certificates of deposit (CDs) were offered at rates of 9 percent or more, some consumers developed the unrealistic expectation that they always could roll over their CDs when they matured at the same or higher rates. Recent successive rate cuts by the Federal Reserve, however, have reduced the interest income received by American consumers by an estimated \$50 billion. As the rates offered by banks on CDs and passbook savings accounts continue a steady slide to the unattractive 2 to 3 percent rate, more and more consumers are rejecting CDs in favor of higher yielding investment options. Since the beginning of 1992, U.S. commercial bank customers have slashed their holdings in "time deposits" such as CDs by more than \$60 billion. The reality for many risk averse consumers is that yields are equally anemic on the limited range of alternatives that are insured or relatively low risk.

Aggressive advertising and telemarketing campaigns are now being mounted to lure consumers into a variety of so called "CD alternatives," even though some of the investment options being promoted are risky, complex and unsuitable for many of those to whom they are being pitched. The Securities Division of the Florida Comptrollers's Office has noted: "Scam artists see this as an easy time to dupe unwary investors. . . . They can promise a plausible-sounding return of 10 percent, rather than an astronomical rate of return of 40 percent or even more to lure money into their investment vehicle. Investors may not realize for months or even years that they have been taken."

Lower interest rates and returns strike particularly hard at the elderly and those with fixed incomes. It is not uncommon to find situations where a retiree who received \$600 a month in interest income last year now takes in only half as much each month. Such precipitous fall offs in household income will trigger tighter budgeting and an increasing and perhaps unwise willingness to take on more risk.

If consumers are not rolling over CDs as they once did, where is all of the money going? An increasing number of consumers are taking on more risk by moving into stocks, bonds, mutual funds, fixed income insurance products such as annuities and other investment vehicles. Indeed, almost any investment product may be marketed as a CD alternative.

When considering putting your money in one of the many CD alternatives, recognize that not all products offered by or through banks are insured. Banks are now going to great lengths to hold onto deposits, including offering investment and insurance